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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-128264-07
Date:
October 16, 2007

X =

A =

B =

Trust =

State =

Property =

Date =

Year =

X =

$$\underline{y} =$$

Dear _____ :

This letter responds to a letter dated June 15, 2007, submitted on behalf of X by X's authorized representative, requesting a ruling that X's rental income from Property 1 is not passive investment income within the meaning of § 1362(d)(3)(C)(i).

The information submitted states that X is incorporated in State. The shareholders of X are B and Trust. Effective Date, X intends to elect to be treated as an S corporation and Trust intends to elect to be treated as an ESBT. X has subchapter C earnings and profits.

A, the President of X, represents that X owns Property. A represents that X, through a related property manager, provides various services to the tenant of Property. These services includes monitoring all exterior and interior maintenance of the property; maintenance and repair of the building structural components and systems, including the roof and the heating system, maintenance of an alleyway; assistance with and supervision of tenant improvements. In addition to the services provided to the tenants, the property manager, on behalf of X, markets Property and negotiates leases, collects rent and a portion of the real estate taxes from the tenant, obtains and pays for insurance and pays the real estate taxes. For Year, X received \$x in rents and X paid or incurred \$y expenses (other than depreciation) with respect to Property.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(d)(3)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and has gross receipts for each of such taxable years more than 25 percent of which are passive investment income. Any termination under this paragraph shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to above.

Section 1362(d)(3)(C)(i) provides that except as otherwise provided, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(ii)(B)(2) of the Income Tax Regulations provides that "rents" does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide

the services and the types and amounts of costs and expenses incurred (other than depreciation).

Based solely on the facts and the representations submitted we conclude that the rental income that X derives from Property is not passive investment income as described in § 1362(d)(3)(C)(i).

Except as specifically set forth above, we express no opinion as to the federal tax consequences of the transaction described above under any other provision of the Code. Specifically, we express no opinion on whether X is a small business corporation eligible to make an S election. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of section § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2

Copy of this letter

Copy for § 6110 purposes